

PERFORMANCE AUDIT
OF THE
MICHIGAN HIGHER EDUCATION ASSISTANCE AUTHORITY
AND THE
MICHIGAN HIGHER EDUCATION STUDENT LOAN AUTHORITY

DEPARTMENT OF TREASURY

April 1998

EXECUTIVE DIGEST

MICHIGAN HIGHER EDUCATION ASSISTANCE AUTHORITY AND MICHIGAN HIGHER EDUCATION STUDENT LOAN AUTHORITY

INTRODUCTION	This report, issued in April 1998, contains the results of our performance audit* of the Michigan Higher Education Assistance Authority (MHEAA) and the Michigan Higher Education Student Loan Authority (MHESLA), Department of Treasury.
AUDIT PURPOSE	This performance audit was conducted as part of the constitutional responsibility of the Office of the Auditor General. Performance audits are conducted on a priority basis related to the potential for improving effectiveness* and efficiency* .
BACKGROUND	MHEAA was established and prescribed certain powers and responsibilities by Act 77, P.A. 1960 (Sections 390.951 - 390.961 of the <i>Michigan Compiled Laws</i>). The Act created MHEAA as a nonprofit authority and as an agency in the Department of Education. MHEAA is comprised of 15 members appointed by the Governor and

* See glossary on page 30 for definition.

one ex-officio member, the State Treasurer, who serves as the chairman of MHEAA.

MHESLA was created and organized by Act 222, P.A. 1975 (Sections 390.1151 - 390.1165 of the *Michigan Compiled Laws*). The Act states that MHESLA was created as a public body corporate and politic within the Department of Education. MHESLA is comprised of the members of MHEAA, as provided by Section 390.1153 of the *Michigan Compiled Laws*.

Effective April 8, 1995, MHEAA and MHESLA were transferred, pursuant to Executive Order 1995-3 (Executive Reorganization Order 1995-2), from the Department of Education to the Department of Treasury.

The objective of the programs operated by MHEAA and MHESLA is to enhance employability prospects for Michigan residents by providing equality of access and freedom of choice to students seeking a postsecondary education.

MHEAA and MHESLA are comprised of five separate offices. As of September 30, 1997, MHEAA and MHESLA had 127.5 full-time equated* employees.

AUDIT OBJECTIVES,
CONCLUSIONS, AND
NOTEWORTHY
ACCOMPLISHMENTS

Audit Objective: To assess the effectiveness and efficiency of MHEAA's and MHESLA's programs and contracted services.

Conclusion: We concluded that MHEAA's and MHESLA's programs and contracted services were generally performed effectively and efficiently. However, we noted reportable conditions* involving a continuous

* See glossary on page 30 for definition.

quality improvement process* , MHEAA program compliance audits, scholarship and grant awards, loan discharge controls, and a refund policy (Findings 1 through 5).

Noteworthy Accomplishments: The Office of the Michigan Guaranty Agency's (MGA's) cooperative effort with other state student loan guarantors in updating the Common Manual culminated in its distribution to MGA clients during fiscal year* 1995-96. The Common Manual is intended to standardize and streamline student loan policies and administration. For the first time since student loan programs began over 30 years ago, all guarantors are administering the Federal Family Education Loan Program with a common policy manual.

Audit Objective: To assess MHEAA's and MHESLA's compliance with State and federal laws and regulations that could have a material effect on the administration of their programs.

Conclusion: We concluded that MHEAA and MHESLA generally operated their programs in compliance with State and federal laws and regulations that could have a material effect on the administration of their programs. However, we noted reportable conditions involving contractor loan collection procedure compliance and annual report timeliness (Findings 6 and 7).

**AUDIT SCOPE AND
METHODOLOGY**

Our audit scope was to examine the program and other records of the Michigan Higher Education Assistance Authority and the Michigan Higher Education Student Loan Authority. Our audit was conducted in accordance with

* See glossary on page 30 for definition.

Government Auditing Standards issued by the Comptroller General of the United States and, accordingly, included such tests of the records and such other auditing procedures as we considered necessary in the circumstances.

Both MGA, within MHEAA, and MHESLA have an annual financial audit* and a biennial Single Audit* performed by a public accounting firm.

Our methodology included an examination of MHEAA, MHESLA, and Department records primarily covering fiscal years 1994-95, 1995-96, and 1996-97.

We surveyed MHEAA and MHESLA programs and identified potential problem areas; determined which of these problem areas had the greatest risk and/or potential to improve the operation of the programs; established audit objectives that defined these areas; and developed and performed audit methodologies that resulted in an assessment of the level of performance or compliance for each audit objectives.

To accomplish our first objective, we reviewed MHEAA's and MHESLA's enabling legislation and identified their responsibilities and program goals* and objectives*. Also, we analyzed MHEAA's and MHESLA's efforts to develop a continuous quality improvement process to evaluate the effectiveness and efficiency of their programs and contracted services.

To accomplish our second audit objective, we examined documentation supporting program services provided and observed program operational practices. We obtained a

* See glossary on page 30 for definition.

random sample of student financial aid records and determined the validity of information related to eligibility for program services. We compared student data submitted to MHESLA with independent sources to verify critical information necessary to obtain loans, scholarships, and grants.

**AGENCY RESPONSES
AND PRIOR AUDIT
FOLLOW-UP**

Our audit report contains 7 findings and 10 corresponding recommendations. The agency's preliminary response indicated that it agreed with 9 of the 10 recommendations. The agency indicated that it had taken steps to comply with some of the recommendations.

The Department of Education complied with 17 of the 20 prior audit recommendations included within the scope of our current audit. The other recommendations are repeated in this audit report.

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Mr. Douglas B. Roberts
State Treasurer
Treasury Building
Lansing, Michigan

Dear Mr. Roberts:

This is our report on the performance audit of the Michigan Higher Education Assistance Authority and the Michigan Higher Education Student Loan Authority, Department of Treasury.

This report contains our executive digest; description of agency; audit objectives, scope, and methodology and agency responses and prior audit follow-up; comments, findings, recommendations, and agency preliminary responses; and a glossary of acronyms and terms.

Our comments, findings, and recommendations are organized by audit objective. The agency preliminary responses were taken from the agency's responses subsequent to our audit fieldwork. The *Michigan Compiled Laws* and administrative procedures require that the audited agency develop a formal response within 60 days after release of the audit report.

We appreciate the courtesy and cooperation extended to us during this audit.

Sincerely,

Thomas H. McTavish, C.P.A.
Auditor General

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Description of Agency

The Michigan Higher Education Assistance Authority (MHEAA) was established and prescribed certain powers and responsibilities by Act 77, P.A. 1960 (Sections 390.951 - 390.961 of the *Michigan Compiled Laws*). The Act created MHEAA as a nonprofit authority and as an agency in the Department of Education. MHEAA is comprised of 15 members appointed by the Governor and one ex-officio member, the State Treasurer, who serves as the chairman of MHEAA.

Michigan Higher Education Student Loan Authority (MHESLA) was created and organized by Act 222, P.A. 1975 (Sections 390.1151 - 390.1165 of the *Michigan Compiled Laws*). The Act states that MHESLA was created as a public body corporate and politic within the Department of Education. MHESLA is comprised of the members of MHEAA, as provided by Section 390.1153 of the *Michigan Compiled Laws*.

Effective April 8, 1995, MHEAA and MHESLA were transferred, pursuant to Executive Order 1995-3 (Executive Reorganization Order 1995-2), from the Department of Education to the Department of Treasury.

As of September 30, 1997, six full-time equated employees were responsible for the executive-level operations of MHEAA and MHESLA.

The objective of the programs operated by MHEAA and MHESLA is to enhance employability prospects for Michigan residents by providing equality of access and freedom of choice to students seeking a postsecondary education.

MHEAA and MHESLA are comprised of five separate offices:

1. Office of the Michigan Guaranty Agency (MGA) - MHEAA established MGA to guarantee loans made to eligible students and their parents through financial institutions approved by MGA. MGA's loan guarantee is designed to encourage financial institutions to make low-interest, long-term educational loans available. To accomplish this, MGA administers four loan programs that guarantee (a) subsidized and unsubsidized federal Stafford Loans; (b) federal Supplemental Loans for Students (SLS); (c) federal Parent Loans for Undergraduate Students;

and (d) federal consolidation loans made by banks, credit unions, savings and loan associations, insurance companies, and certain federal agencies. There was no new subsequent guaranty activity in the SLS loan program because of the elimination of the program on July 1, 1994.

MGA entered into a supplemental guaranty agreement with the federal government, through which the federal government reinsures the loans guaranteed by MGA and will provide up to 100% reimbursement, depending on MGA's default experience as specified in the agreement. Federal reinsurance on guaranteed loans made on or after October 1, 1993 decreased to a maximum of 98%. MGA's fiscal year 1996-97 default rate was 2.67%, which allowed MGA to receive 98% reimbursement from the federal government.

MGA guaranteed approximately 92,000 loans with an approximate value of \$314.5 million during fiscal year 1996-97. As of September 30, 1997, MGA had guaranteed approximately 2.2 million student loans with an approximate value of \$5.3 billion since its inception. Of these loans, approximately \$2.6 billion were outstanding as of September 30, 1997.

MGA is self-supporting, financing its operations primarily from investment and fee income, loan recoveries, and federal administrative cost allowances. For fiscal year 1996-97, MGA had revenues of approximately \$95.7 million and expenses of approximately \$92.4 million. As of September 30, 1997, MGA had 59 full-time equated employees involved in administering its programs.

2. Office of Student Loan Authority Programs (SLA) - MHESLA established SLA to provide loans to eligible students attending participating institutions of higher learning, to provide loans to parents of these students, and to acquire loans made to eligible students and their parents. To accomplish these responsibilities, SLA administers the Michigan Direct Student Loan Program, the State Secondary

Market, and the Michigan Alternative Student Loan (MI-LOAN) Program. The following chart summarizes the loan program activity:

SLA LOAN PROGRAM ACTIVITY

<u>Loan Program</u>	<u>Number of Loans Made During Fiscal Year 1996-97</u>	<u>Value of Loans Made/Acquired During Fiscal Year 1996-97</u>	<u>Number of Loans Made Since Program Inception as of September 30, 1997</u>	<u>Value of Loans Made/Acquired Since Program Inception as of September 30, 1997</u>
Michigan Direct Student Loan Program	2,942	\$ 18,000,000	226,267	\$534,100,000
State Secondary Market	64,286	\$159,400,000	209,836	\$511,500,000
MI-LOAN Program	1,744	\$ 9,700,000	7,208	\$ 40,100,000

SLA is self-supporting, obtaining capital for financing its student loan programs through the issuance of tax-exempt and taxable bonds, as provided by Section 390.1154 of the *Michigan Compiled Laws*. The bonds issued by MHESLA are not obligations of the State of Michigan. As of September 30, 1997, MHESLA had approximately \$672.9 million in outstanding bond principal. For fiscal year 1996-97, MHESLA had revenues of approximately \$55.3 million and expenses of approximately \$54.2 million. As of September 30, 1997, SLA had 28 full-time equated employees involved in administering its programs.

3. Office of Scholarships and Grants (OSG) - OSG administers the Michigan Competitive Scholarship Program, Michigan Tuition Grant Program, Paul Douglas Teacher Scholarship Program, and the Robert C. Byrd Honors Scholarship Program. OSG awarded approximately \$85.7 million of State appropriations to more than 60,000 Michigan residents during fiscal year 1996-97. As of September 30, 1997, OSG had awarded over \$1.2 billion of State appropriations through more than 1.1 million awards since its inception.

As of September 30, 1997, OSG had 14 full-time equated employees involved in administering its programs.

4. Office of Support Services and Programs (OSSP) - OSSP administers and monitors campus-based and other special financial aid programs, including reviews of institutional practices and documentation for compliance with program requirements; leads and coordinates outreach and information services; operates a computerized financial aid search service; and conducts research and policy analysis activities under the purview of MHEAA and MHESLA. OSSP awarded financial aid of more than \$21.0 million of State appropriations during fiscal year 1996-97.

As of September 30, 1997, OSSP had 7 full-time equated employees involved in administering its programs.

5. Office of Fiscal Affairs (OFA) - OFA acts as controller and treasurer for MHEAA and MHESLA. OFA develops and implements accounting and financial policies and procedures for the areas of accounting and reporting, cash management and investing, bond financing, audits, and budgeting. OFA directs bond issues and other financing activities to ensure that MHESLA maintains sufficient capital to make and acquire student loans.

As of September 30, 1997, OFA had 13.5 full-time equated employees involved in administering its responsibilities.

Audit Objectives, Scope, and Methodology and Agency Responses and Prior Audit Follow-Up

Audit Objectives

Our performance audit of the Michigan Higher Education Assistance Authority (MHEAA) and the Michigan Higher Education Student Loan Authority (MHESLA), Department of Treasury, had the following objectives:

1. To assess the effectiveness and efficiency of MHEAA's and MHESLA's programs and contracted services.
2. To assess MHEAA's and MHESLA's compliance with State and federal laws and regulations that could have a material effect on the administration of their programs.

Audit Scope

Our audit scope was to examine the program and other records of the Michigan Higher Education Assistance Authority and the Michigan Higher Education Student Loan Authority. Our audit was conducted in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States and, accordingly, included such tests of the records and such other auditing procedures as we considered necessary in the circumstances.

Both the Office of the Michigan Guaranty Agency, within MHEAA, and MHESLA have an annual financial audit and a biennial Single Audit performed by a public accounting firm.

Audit Methodology

Our work was performed between April and October 1997 and included an examination of MHEAA, MHESLA, and Department records primarily covering fiscal years 1994-95, 1995-96, and 1996-97.

We surveyed MHEAA and MHESLA programs and identified potential problem areas; determined which of these problem areas had the greatest risk and/or potential to improve the operation of the programs; established audit objectives that defined these

areas; and developed and performed audit methodologies that resulted in an assessment of the level of performance or compliance for each audit objectives.

To accomplish our first audit objective, we reviewed MHEAA's and MHESLA's enabling legislation and identified their responsibilities and program goals and objectives. Also, we analyzed MHEAA and MHESLA efforts to develop a continuous quality improvement process to evaluate the effectiveness and efficiency of their programs and contracted services.

To accomplish our second audit objective, we examined documentation supporting program services provided and observed program operational practices. We obtained a random sample of student financial aid records and determined the validity of information related to eligibility for program services. We compared student data submitted to MHESLA to independent sources to verify critical information necessary to obtain loans, scholarships, and grants.

Agency Responses and Prior Audit Follow-Up

Our audit report contains 7 findings and 10 corresponding recommendations. The agency's preliminary response indicated that it agreed with 9 of the 10 recommendations. The agency indicated that it had taken steps to comply with some of the recommendations.

The agency preliminary response which follows each recommendation in our report was taken from the agency's written comments and oral discussion subsequent to our audit fieldwork. Section 18.1462 of the *Michigan Compiled Laws* and Department of Management and Budget Administrative Guide procedure 1280.02 require the Department of Treasury to develop a formal response to our audit findings and recommendations within 60 days after release of the audit report.

The Department of Education complied with 17 of the 20 prior audit recommendations included within the scope of our current audit. The other recommendations are repeated in this audit report.

COMMENTS, FINDINGS, RECOMMENDATIONS, AND AGENCY PRELIMINARY RESPONSES

EFFECTIVENESS AND EFFICIENCY

COMMENT

Audit Objective: To assess the effectiveness and efficiency of the Michigan Higher Education Assistance Authority's (MHEAA's) and the Michigan Higher Education Student Loan Authority's (MHESLA's) programs and contracted services.

Conclusion: We concluded that MHEAA's and MHESLA's programs and contracted services were generally performed effectively and efficiently. However, we noted reportable conditions involving a continuous quality improvement process, MHEAA program compliance audits, scholarships and grant awards, loan discharge controls, and a refund policy.

Noteworthy Accomplishments: The Office of Michigan Guaranty Agency's (MGA's) cooperative effort with other state student loan guarantors in updating the Common Manual culminated in its distribution to MGA clients during fiscal year 1995-96. The Common Manual is intended to standardize and streamline student loan policies and administration. For the first time since student loan programs began over 30 years ago, all guarantors are administering the Federal Family Education Loan Program with a common policy manual.

FINDING

1. Continuous Quality Improvement Process

MHEAA and MHESLA (the Authorities) had not established a continuous quality improvement process to evaluate and improve the effectiveness of their programs.

The objective of the Authorities' programs is to enhance the employability prospects for Michigan residents by providing equality of access and freedom of choice to students seeking a postsecondary education. The Authorities' ability to determine the effectiveness of their programs is important because of the size of the programs and their impact on program participants. During fiscal year 1996-

97, the Authorities' programs distributed in excess of \$438.8 million through more than 271,000 loans, grants, and scholarships to students.

Developing a continuous quality improvement process to evaluate program performance is critical to ensure that the Authorities use their funds most effectively and to allow the Authorities to identify and make needed program revisions.

A continuous quality improvement process should include the following elements: performance indicators* for measuring outputs* and/or outcomes* ; performance standards* or goals that describe the desired level of outcomes; a management information system to gather accurate performance data; a comparison of performance data to desired outputs and/or outcomes; procedures to report the comparison results to management; and procedures to propose program changes to improve effectiveness.

We acknowledge that the Authorities have developed some performance indicators for measuring outputs and that they have established a management information system to gather performance data. However, the Authorities need to do more to develop the other elements of a continuous quality improvement process. For example, we noted little evidence that the Authorities had established measurable outcome related goals. Consequently, the Authorities could not demonstrate the success of their programs by measuring the progress toward achieving program goals.

RECOMMENDATION

We recommend that the Authorities establish a continuous quality improvement process to evaluate and improve the effectiveness of their programs.

** See glossary on page 30 for definition.*

AGENCY PRELIMINARY RESPONSE

The Authorities agree that they have not established formal performance standards and measurable program performance criteria; however, they disagree with the recommendation that they do not have an established continuous quality improvement process.

FINDING

2. MHEAA Program Compliance Audits

MHEAA had not conducted compliance audits at colleges and universities to determine that these institutions properly administered and monitored the competitive scholarship and tuition grant programs. Also, during fiscal year 1994-95, MHEAA discontinued conducting audits of Office of Support Services and Programs' (OSSP's) financial aid programs at colleges and universities for compliance with State laws and regulations.

During fiscal year 1996-97, MHEAA distributed approximately \$87.0 million in financial aid to students through various financial aid programs offered at 96 eligible colleges and universities in the State. MHEAA's responsibilities for administering these financial aid programs included periodically performing compliance audits of colleges' and universities' administration of the financial aid programs for compliance with State laws and regulations. MHEAA has accepted and recognized its responsibility to conduct compliance audits by establishing a review position; developing program compliance audit procedures for its campus-based programs; and by requesting funds, for several fiscal years, to fill a position to audit competitive scholarship and tuition grants.

Annual State-funded financial aid program appropriations acts also have required the Office of the Auditor General to conduct annual audits of a limited sample of private colleges for the purpose of evaluating the effectiveness of each college's existing internal control structure* . Our last three annual compliance audits of private colleges indicated weaknesses in the colleges' internal control structures

* See glossary on page 30 for definition.

over student eligibility for State-funded financial aid programs. Compliance audits by MHEAA are a necessary part of the internal control structure as proven by the high frequency of exceptions disclosed by our audits.

MHEAA distributed program operational manuals to each eligible college and university participating in its financial aid programs. Colleges and universities are to use these manuals to help them administer and monitor their financial aid programs in compliance with State law. MHEAA relies on colleges and universities to monitor and report changes to student program eligibility throughout the school year. In addition, MHEAA uses other data provided by colleges and universities, such as enrollment and academic progress reports, to determine that students, colleges, and universities meet applicable program requirements.

Performing compliance audits of colleges' and universities' State-funded financial aid programs would allow MHEAA to ensure college and university compliance with applicable laws and regulations.

We reported this same condition in our prior audit report. MHEAA responded that it concurred with our related recommendation and had initiated efforts to establish program audits consistent with available resources.

RECOMMENDATIONS

WE AGAIN RECOMMEND THAT MHEAA CONDUCT COMPLIANCE AUDITS AT COLLEGES AND UNIVERSITIES TO DETERMINE THAT THESE INSTITUTIONS PROPERLY ADMINISTER AND MONITOR THE COMPETITIVE SCHOLARSHIP AND TUITION GRANT PROGRAMS.

WE ALSO AGAIN RECOMMEND THAT MHEAA REINSTATE ITS AUDITS OF OSSP's FINANCIAL AID PROGRAMS AT COLLEGES AND UNIVERSITIES FOR COMPLIANCE WITH STATE LAWS AND REGULATIONS.

AGENCY PRELIMINARY RESPONSE

While MHEAA has agreed in the past on the need to begin an audit process, State funding necessary to provide the staffing for this process has not been provided. MHEAA agrees with the first recommendation and will seek funding to comply with

it. MHEAA also agrees with the second recommendation and will reinstate program reviews of the colleges and universities participating in the programs administered by OSSP to ensure compliance with State laws and regulations governing institutional and student eligibility. A schedule of program reviews for the current year has been established consistent with current staffing levels.

FINDING

3. Scholarship and Grant Awards

MHEAA's internal control structure over its student information database did not reasonably ensure that student data used to determine eligibility for the State-funded Competitive Scholarship and Tuition Grant Programs was accurate and complete. Also, MHEAA's internal control structure over its automated payment system did not reasonably ensure that awards were provided only to eligible recipients.

MHEAA awarded over \$248 million to 177,603 scholarship and grant recipients for the three fiscal years ended September 30, 1997. Our review of the data contained on the student information database for these recipients disclosed:

- a. MHEAA did not update its student information database for revisions to student family financial information. These revisions would have changed the calculated family financial contribution for 872 students who received approximately \$255,000 more than their financial need. Of the 872 students, 306 students, whose revised calculated family financial contribution resulted in the students having no financial need, received approximately \$186,000 in scholarships and grants. MHEAA did not revise the database for changes in financial need for 18 of 306 students. Such revisions would have indicated overawards to these students.
- b. MHEAA did not update the student information database for revisions to students' enrollment status which resulted in errors in students' unmet financial need. Unmet financial need is the amount of a student's financial need that remains after scholarship and/or grant awards. Colleges and universities use student unmet financial need as contained in the student information database in awarding other financial aid to the student. Our

calculation of unmet financial need disclosed different amounts than those contained in the student information database for 7 (12%) of 60 students tested. These 7 students' unmet financial need would have ranged from \$329 to \$1,810 higher if MHEAA had updated its database for the revisions to the student's enrollment status.

- c. The state of residency information contained in the database was blank for 74 students. Section 390.974 of the *Michigan Compiled Laws* requires that students be Michigan residents to be eligible to receive a scholarship or a grant. Developing database controls to deny the acceptance of incomplete data into the database would help ensure that only Michigan residents are eligible to receive scholarships or grants.
- d. MHEAA had not followed up on 211 students whose age as contained in the database was 15 or less. Of these students, 54 were reported to have been born during, or after, the year in which the students applied for financial aid. Although age is not a factor for determining eligibility for an award, Section 388.1621(b) of the *Michigan Compiled Laws* prohibits a student from receiving a grant or scholarship to attend a postsecondary institution when simultaneously enrolled in high school. Following up on students whose age indicates possible high school enrollment would help ensure MHEAA does not provide grants or scholarships to students enrolled in high school.
- e. MHEAA's automated payment system did not contain the necessary controls to limit student awards to the maximum specified by Sections 390.993 and 390.975 of the *Michigan Compiled Laws*. As a result, MHEAA provided awards to 17 students in excess of the cumulative number of awards allowed. Developing a payment system control to limit the cumulative number of awards that a student receives would help MHEAA ensure that awards are in compliance with the *Michigan Compiled Laws*.

Enhancing controls over the student information database to include editing the information would help ensure complete and accurate student data from which staff can determine eligibility for scholarships and grants. Such enhancements would also help ensure that MHEAA, colleges, and universities provide accurate awards to eligible students. State-funded financial aid is limited; therefore, by

excluding ineligible students, MHEAA could provide scholarships and grants to more eligible students who would not have received an award because of a lack of funds.

We reported this same condition in our prior audit. MHEAA responded that it agreed in concept with our recommendation; however, MHEAA did not take additional steps to reduce awards to ineligible students. MHEAA responded that, because external factors beyond its control (e.g., the U.S. Department of Education, colleges and universities, and students) impact the completeness and accuracy of information used to determine student eligibility and scholarship and grant awards, an enhanced control structure will not completely ensure accurate receipt or timely processing of information in all cases.

RECOMMENDATIONS

WE AGAIN RECOMMEND THAT MHEAA ENHANCE ITS CONTROLS TO HELP ENSURE THAT STUDENT DATA CONTAINED IN ITS STUDENT INFORMATION DATABASE IS ACCURATE AND COMPLETE.

We also recommend that MHEAA develop controls over its automated payment system to help ensure that awards are provided only to eligible recipients.

AGENCY PRELIMINARY RESPONSE

MHEAA agrees with both recommendations. Also, MHEAA agrees that the database needs to be enhanced to provide accurate and complete information, and it will be reviewing the viability of the current system within the next six months. This review may well result in changing the current platform from a mainframe to a client server structure. Whether the system is restructured or rehabilitated, MHEAA will work closely with the Department's Information Technology Services Division to ensure enhanced functionality in order to improve compliance as well as service to all MHEAA constituents.

FINDING

4. Loan Discharge Controls

MHEAA had not established an internal control structure sufficient to ensure the proper discharge of defaulted loans purchased from lenders. As a result, MHEAA was unable to demonstrate that it approved all loans discharged.

MHEAA continuously purchases defaulted loans from lenders as part of its guaranty responsibilities. For the fiscal year ended September 30, 1997, MHEAA acquired over 14,800 defaulted loans totaling approximately \$50.4 million. Upon the compilation of sufficient documentation, MHEAA approved the discharge of loans for various reasons, such as bankruptcy, disability, and death of the borrowers. MHEAA did not maintain records to document the actual number of defaulted loans discharged.

During our review, we noted the following weaknesses in the internal control structure over discharged loans:

- a. One individual responsible for approving the discharge of loans also had computer system access that enabled the individual to record the discharge on MHEAA's computer database.
- b. MHEAA did not generate a report of all loans discharged from the computer database to periodically reconcile with records of loan discharge approvals. Therefore, MHEAA was unable to document that it approved all loans discharged.

The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly.

Developing and implementing defaulted loan discharge controls would help ensure, and allow MHEAA to demonstrate, that only properly approved defaulted loans are discharged from MHEAA's computer database.

RECOMMENDATION

We recommend that MHEAA establish an internal control structure sufficient to ensure the proper discharge of defaulted loans purchased from lenders.

AGENCY PRELIMINARY RESPONSE

MHEAA agrees with this recommendation. The employee responsible for approving the discharge of loans is no longer permitted computer system access to record discharged loans on MHEAA's computer database. In addition, MHEAA will reconcile records of loan discharge approvals with the computer database reports for loan discharges to confirm that the number of discharged loans matches the number of loan discharge approvals.

FINDING

5. Refund Policy

MHEAA had not established a policy that requires State-funded financial aid recipients who were determined to be ineligible subsequent to receiving financial aid to refund the amounts received.

Revisions to student financial aid program eligibility occur continuously as MHEAA, colleges, and universities verify eligibility data provided by students. These revisions can reduce or eliminate the student's eligibility for financial aid already received. For the three fiscal years ended September 30, 1997, MHEAA terminated the financial aid program eligibility for more than 300 students because of revisions to their eligibility data. However, MHEAA provided these students more than \$185,000 in financial aid prior to terminating future award payments. MHEAA did not require the students to refund the financial aid for which they were ineligible because its policy was only to cancel future aid payments.

The application for federal student financial aid states that students who receive federal aid based on incorrect information will be required to pay it back. The application also states that if students provide false or misleading information on the application, they may be fined \$10,000 and/or sent to prison.

Establishing a refund policy with a penalty for obtaining financial aid based on inaccurate information would provide a program deterrent to those students who knowingly provide inaccurate information. Also, a refund policy would enable MHEAA to provide refunded amounts to other eligible students.

RECOMMENDATION

We recommend that MHEAA establish a policy that requires State-funded financial aid recipients who are determined to be ineligible subsequent to receiving financial aid to refund the amounts received.

AGENCY PRELIMINARY RESPONSE

MHEAA will begin a review process of related federal and State regulations and policy in order to determine the most appropriate way to implement this recommendation. There are suggested changes forthcoming within the Reauthorization of the Higher Education Act of 1965, as amended, that may change the federal refund policy, which may, in turn, affect how MHEAA will want to proceed in developing policy.

COMPLIANCE

COMMENT

Audit Objective: To assess MHEAA's and MHESLA's compliance with State and federal laws and regulations that could have a material effect on the administration of their programs.

Conclusion: We concluded that MHEAA and MHESLA generally operated their programs in compliance with State and federal laws and regulations that could have a material effect on the administration of their programs. However, we noted reportable conditions involving contractor loan collection procedure compliance and annual report timeliness.

FINDING

6. Contractor Loan Collection Procedure Compliance

MHESLA did not always follow required procedures when monitoring the contractor responsible for collecting delinquent loans in the Michigan Alternative Student Loan (MI-LOAN) Program to ensure compliance with collection requirements contained in the service contract.

MHESLA contracted with a loan servicing agency to perform procedures designed to collect delinquent student loans. Activities specified in the service contract included telephone calls and written correspondence at specific time intervals. MI-LOAN procedures required MHESLA to monitor contractor compliance with the collection activities by reviewing monthly collection activity as shown on the loan account history for all 60-day delinquent loan accounts. MHESLA documented its review by completing a form designed to identify the lack of collection activity compliance. If the contractor did not maintain certain levels of compliance with the collection requirements, MHESLA was supposed to communicate the instances of noncompliance to the contractor.

Our review of the loan account records for a random sample of 8 of the 60 students who had delinquent loans, as of June 30, 1997, disclosed that MHESLA did not properly monitor contractor compliance with collection activities and/or communicate the instances of noncompliance to the contractor:

- a. MHESLA failed to identify and document at least one collection procedure performed by the contractor for all of the loan accounts reviewed. Failing to identify and document all contractor-performed collection procedures may lead MHESLA to incorrectly conclude that the contractor did not comply with established collection procedures.
- b. We identified 3 instances in which the contractor failed to make the required "25 day" telephone contacts* or attempted contacts for 3 of the 8 student loan accounts reviewed. For each of the accounts, the contractor failed to perform two or more required contacts. For these 3 accounts, MI-LOAN procedures

* See glossary on page 30 for definition.

required that MHESLA communicate the instances of noncompliance to the contractor. MHESLA did not identify or document these instances of noncompliance during its review of the loan accounts; therefore, it did not communicate the instances of noncompliance to the contractor.

Monitoring contractor compliance with procedures designed to increase loan repayments would help ensure that MHESLA obtains the maximum benefit for funds expended and provide an additional basis for evaluating the contractor for future services.

RECOMMENDATION

We recommend that MHESLA follow required procedures when monitoring the contractor responsible for collecting delinquent loans in the MI-LOAN Program to ensure compliance with collection requirements contained in the service contract.

AGENCY PRELIMINARY RESPONSE

MHESLA agrees with the recommendation and has taken steps to comply. To resolve the issues noted in the finding, staff have been retrained.

FINDING

7. Annual Report Timeliness

MHEAA had not submitted an annual report on its operations to the Governor and Legislature for each of the three fiscal years ended September 30, 1996 as required by the *Michigan Compiled Laws*. Also, MHESLA had not prepared an annual report of its operations for the same fiscal years in a timely manner.

Section 390.960 of the *Michigan Compiled Laws* requires MHEAA to submit an annual report to the Governor and Legislature within 60 days after the Legislature convenes.

Although not required by statute, MHESLA has presented the results of its operations in a combined annual report with MHEAA operations since MHESLA's first full year of operations in fiscal year 1976-77. MHESLA management has stated that reporting on the operations of MHESLA is important because of the

significance of its programs in complimenting MHEAA programs. For example, for the three fiscal years ended September 30, 1997, MHESLA provided more than 17,500 loans, valued at approximately \$93.5 million, to student borrowers through its Michigan Direct Loan and MI-LOAN programs. Also, for the same fiscal years, MHESLA acquired over 113,000 loans from Michigan lenders valued at approximately \$286.0 million. In addition, reporting on MHEAA and MHESLA operations provides complete information on the student financial aid provided to Michigan students and their parents.

As of September 30, 1997 (more than 6 months after MHEAA's required annual report submission date), MHEAA had not submitted, and MHESLA had not prepared, an annual report of operations for the fiscal year ended September 30, 1996. MHEAA and MHESLA submitted annual reports of operations for the fiscal years ended September 30, 1995 and September 30, 1994 in November 1996 and September 1995, respectively. These reports were submitted 8 months and 6 months, respectively, after MHEAA's required annual report submission date.

Submitting an annual report of MHEAA operations in compliance with Section 390.960 of the *Michigan Compiled Laws* concurrently with an annual report of MHESLA operations would provide interested users the information on a timely basis.

RECOMMENDATIONS

We recommend that MHEAA submit an annual report on its operations to the Governor and Legislature within 60 days after the Legislature convenes as required by Section 390.960 of the *Michigan Compiled Laws*.

We also recommend that MHESLA prepare an annual report of its operations in a timely manner.

AGENCY PRELIMINARY RESPONSE

The Authorities agree with the recommendations that both MHEAA and MHESLA prepare and submit an annual report of operations in a timely manner and pursuant to Section 390.960 of the *Michigan Compiled Laws*. Staff have taken steps to streamline the report, reducing duplicate data elements that have contributed to the lengthy process of compiling the report.

Glossary of Acronyms and Terms

Authorities	MHEAA and MHESLA.
continuous quality improvement process	A management system which focuses on the needs and expectations of internal and external customers and is designed to improve how products and services are provided.
effectiveness	Program success in achieving mission and goals.
efficiency	Achieving the most outputs and outcomes practical for the amount of resources applied or minimizing the amount of resources required to attain a certain level of outcomes or outputs.
financial audit	An audit that is designed to provide reasonable assurance about whether the financial statements/schedules of an audited entity are fairly presented in conformity with generally accepted accounting principles.
fiscal year	October 1 through September 30 for the State.
full-time equated	Equating to 2,080 hours of continuous service.
goals	The agency's intended outcomes or impacts for a program to accomplish its mission.
internal control structure	The management control environment, management information system, and control policies and procedures established by management to provide reasonable assurance that goals are met; that resources are used in compliance with laws and regulations; and that valid and

reliable performance related information is obtained and reported.

MGA	Office of the Michigan Guaranty Agency.
MHEAA	Michigan Higher Education Assistance Authority.
MHESLA	Michigan Higher Education Student Loan Authority.
MI-LOAN Program	Michigan Alternative Student Loan Program.
objectives	Specific outputs a program seeks to perform and/or inputs a program seeks to apply in its efforts to achieve its goals.
OFA	Office of Fiscal Affairs.
OSG	Office of Scholarships and Grants.
OSSP	Office of Support Services and Programs.
outcomes	The actual impacts of the program. Outcomes should positively impact the purpose for which the program was established.
outputs	The products or services produced by the program. The program assumes that producing its outputs will result in favorable program outcomes.
performance audit	An economy and efficiency audit or a program audit that is designed to provide an independent assessment of the performance of a governmental entity, program, activity, or function to improve public accountability and to facilitate decision making by parties responsible for overseeing or initiating corrective action.

performance indicators	Information of a quantitative or qualitative nature indicating program outcomes, outputs, or inputs. Performance indicators are typically used to assess achievement of goals and/or objectives.
performance standards	A desired level of output or outcome as identified in statutes, regulations, contracts, management goals, industry practices, peer groups, or historical performance.
reportable condition	A matter coming to the auditor's attention that, in his/her judgment, should be communicated because it represents either an opportunity for improvement or a significant deficiency in management's ability to operate a program in an effective and efficient manner.
Single Audit	A financial audit performed in accordance with the Single Audit Act of 1984 that is designed to meet the needs of all federal grantor agencies and other financial report users. A Single Audit is a financial audit which requires additional study and evaluation of the internal control structure and testing of compliance with laws and regulations relevant to federal assistance programs.
SLA	Office of Student Loan Authority Programs.
SLS	Supplemental Loans for Students.
"25 day" telephone contact	Telephone contact required 25 days after contractor collection efforts begin.